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Department of the Treasury  
Washington, DC 20224

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Refer Reply To:  
CC:PSI:B03  
PLR-133862-07  
Date:  
January 17, 2008

### LEGEND

Company =

Date1 =

Date2 =

Date3 =

Date4 =

Date5 =

Date6 =

Date7 =

Year1 =

Year2 =Year3 =

Year4 =

Year5 =

Year6 =

A =

B =

C =

D =

E =

F =

IRA1 =

IRA2 =

IRA3 =

IRA4 =

IRA5 =

IRA6 =

Shareholders =

Shareholders        =  
(cont.)

Shareholders =  
(cont.)

Dear :

This letter responds to your letter dated July 23, 2007, submitted on behalf of Company, requesting a ruling under § 1362(f) of the Internal Revenue Code.

#### FACTS

Company was incorporated on Date1 and elected under § 1362(a) to be an S corporation, effective Date1. On Date2, Company issued stock to Shareholders.

On Date3, A transferred a portion of his/her Company stock to IRA1. On Date4, B transferred a portion of his/her Company stock to IRA2. These shareholders and their respective IRAs continued to own Company stock throughout Year1, Year2, Year3, and Year4.

On Date5, C, D, E, and F transferred all of their Company stock to IRA3, IRA4, IRA5, and IRA6, respectively. These IRAs continued to own such stock through Year3 and Year4.

In Year5, Company learned that the IRAs were ineligible shareholders in Company. On Date6, Company redeemed all of the shares of Company stock held by IRA1 and IRA2, and redeemed a portion of the shares held by IRA3, IRA4, IRA5, and

IRA6. The balance of the Company stock held by IRA3, IRA4, IRA5, and IRA6 was distributed to C, D, E, and F, respectively. As of Date7, no Company stock was held by IRA1, IRA2, IRA3, IRA4, IRA5, or IRA6.

In Year6, Company learned that its S corporation election may have terminated due to an ineligible shareholder owning Company stock. Accordingly, Company seeks relief pursuant to § 1362(f).

### LAW AND ANALYSIS

Section 1361(a) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides that the term “small business corporation” means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(d)(2)(B) provides that any termination under § 1362(d)(2) shall be effective on and after the date of cessation.

Section 1362(f) provides, in part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period; then, notwithstanding the circumstances resulting in such termination, the

corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(d) of the Income Tax Regulations provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner. In the case of a transfer of stock to an ineligible shareholder that causes an inadvertent termination under § 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of an S corporation during the period the ineligible shareholder actually held stock in the corporation. Moreover, the Commissioner may require protective adjustments that prevent any loss of revenue due to a transfer of stock to an ineligible shareholder (e.g., a transfer to a nonresident alien.)

### CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that the termination of Company's S corporation election due to the transfer of Company stock to IRA1, IRA2, IRA3, IRA4, IRA5, and IRA6, was inadvertent within the meaning of § 1362(f).

Therefore, under the provisions of § 1362(f), Company will continue to be treated as an S corporation for the period from Date3 to Date7 and thereafter, provided that Company's S corporation election is valid and not otherwise terminated under § 1362(d). Accordingly, for the time that IRA1, IRA2, IRA3, IRA4, IRA5, and IRA6 held Company stock, the shareholders A, B, C, D, E, and F must include their pro rata shares of the separately and nonseparately computed items attributable to these shares in their income as provided in § 1366, make adjustments to the stock basis of those shares as provided in § 1367, and take into account any distributions with respect to those shares as provided in § 1368.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning Company's eligibility to be an S corporation. Further, we express or imply no opinion concerning whether the Shareholders are eligible shareholders for purposes of § 1361(b)(1).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

/s/

Leslie H. Finlow  
Senior Technician Reviewer, Branch 3  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this letter  
Copy for § 6110 purposes

cc: